

Docket Nos. 105342, 105348, 105349 cons.

**IN THE
SUPREME COURT
OF
THE STATE OF ILLINOIS**

**THE CITY OF CHICAGO, Appellee, v. COMCAST CABLE
HOLDINGS, L.L.C., *et al.*, Appellants.**

Opinion filed November 20, 2008.

JUSTICE KILBRIDE delivered the judgment of the court, with opinion.

Chief Justice Fitzgerald and Justices Freeman, Thomas, Garman, Karmeier, and Burke concurred in the judgment and opinion.

OPINION

The City of Chicago filed a complaint against the defendants, all operators of local cable television systems, in a dispute over cable franchise fees, seeking declaratory relief. Specifically, the City alleged the defendants violated their cable franchise renewal agreements by discontinuing payment of a portion of a 5% franchise fee required by the agreements. In a joint motion to dismiss, the defendants argued that the contractual fee provision was preempted by section 542(b) of the Cable Communications Policy Act of 1984 (Communications Act) (47 U.S.C. §547 (2000)), as interpreted by the Federal Communications Commission (FCC). The trial court granted the defendants' motion to dismiss. The appellate court reversed and

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remanded the cause for further proceedings, concluding there was no clear showing of preemption. 375 Ill. App. 3d 595.

We allowed and consolidated the defendants' petitions for leave to appeal. The central issue is whether the contractual franchise fee provision imposing a 5% fee on defendants' gross cable modem service revenues is preempted by section 542(b) of the Communications Act. If it is preempted, we must consider whether the City has an alternative right to impose that fee under its home-rule authority, as granted by state law. After examining both issues, we reverse the appellate court judgment and affirm the circuit court's dismissal of the City's complaint.

FACTS

In September 2002, the City of Chicago filed a complaint in the circuit court of Cook County against seven defendants providing local services over a cable system. The seven defendants were Comcast Cable Holdings, L.L.C., Comcast of Chicago, Inc., Comcast of Illinois III, Inc., Comcast of South Chicago, Inc., Comcast of Florida/Illinois/Michigan, Inc., RCN Cable TV of Chicago, Inc., and Wideopenwest Illinois, Inc. The complaint sought a declaratory judgment as well as any other just and appropriate relief, including injunctive or equitable relief. The complaint alleged that in March 2002, each of the defendants violated its franchise renewal agreement with the City by refusing to pay the portion of the franchise fee based on the annual gross revenue derived from its provision of cable modem service. Cable modem service uses cable system facilities and equipment to provide Internet access and services to subscribers. *In re Inquiry Concerning High-Speed Access to the Internet Over Cable & Other Facilities*, 17 F.C.C.R. 4798, 4821, ¶38 (FCC March 15, 2002) (FCC Ruling). Previously, each defendant had paid the entire fee requested by the City under section 4.1 of the agreement.

A March 15, 2002, FCC ruling classifying cable modem service as an information service rather than a cable service prompted the defendants' refusal to pay that portion of the franchise fee. See FCC Ruling, 17 F.C.C.R. at 4819, ¶33. They argued that the FCC Ruling excluded revenue from cable modem services from the calculation of the gross revenues used to set the 5% franchise fee ceiling. FCC

Ruling, 17 F.C.C.R. at 4851, ¶105. The defendants allege that the ruling preempted that portion of the franchise fee provision in their renewal agreements with the City, thus eliminating their payment obligation. Because the relevant provisions in each of the franchise renewal agreements are identical, we will refer to them in the singular form throughout our discussion.

The defendants removed the cause of action to federal court and filed a joint motion to dismiss, alleging that the disputed portion of the franchise fee was preempted by the Communications Act (47 U.S.C. §§521 through 573 (2000)) and the Internet Tax Freedom Act (47 U.S.C. §151 note (2000)). The federal district court granted the defendants' motion to dismiss (*City of Chicago v. AT&T Broadband, Inc.*, No. 02-C-7517 (N.D. Ill. September 4, 2003)), and the City appealed. The Seventh Circuit Court of Appeals vacated the federal district court judgment and remanded the cause to the Cook County circuit court, citing lack of federal jurisdiction, without ruling on the merits of the motion to dismiss. *City of Chicago v. Comcast Cable Holdings, L.L.C.*, 384 F.3d 901 (7th Cir. 2004).

In the Cook County circuit court, the defendants again filed a joint motion to dismiss, and the trial court granted the motion, finding that section 542 of the Communications Act preempted the portion of the franchise agreement calculating franchise fees based on gross revenues from cable modem services. The City appealed, and the appellate court reversed the trial court's dismissal order, denying the petition for rehearing filed by Comcast. 375 Ill. App. 3d 595. In approving the agreement's use of cable modem service revenues in the calculation of the franchise fee, the appellate court found that the City's home-rule authority was not preempted by section 542 and concluded that the franchise agreement did not violate the Internet Tax Freedom Act. 375 Ill. App. 3d 595. The defendants filed petitions for leave to appeal under Supreme Court Rule 315 (210 Ill. 2d R. 315), and this court allowed and consolidated the petitions.

ANALYSIS

I. Section 542(b) Preemption

At the heart of the parties' dispute is whether section 542(b) of the Communications Act (47 U.S.C. §542(b) (2000)) preempts the City's

franchise fee because it relies, in part, on revenues from cable modem services. Under the FCC's 2002 ruling, franchise fees may be based only on gross revenues from cable services, excluding cable modem service revenues from its calculation.

While preemption may not be presumed, three distinct types of preemption are recognized: (1) express preemption, shown by a clear expression of congressional intent to preempt state law; (2) field preemption, shown by comprehensive legislation demonstrating a clear congressional intent to occupy the entire regulatory field; and (3) conflict preemption, shown by a conflict between state and federal law. *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541, 150 L. Ed. 2d 532, 550, 121 S. Ct. 2404, 2414 (2001). Because federal preemption presents a question of law, it is subject to *de novo* review. *Kinkel v. Cingular Wireless, LLC*, 223 Ill. 2d 1, 15 (2006). Similarly, appellate review of an order granting a motion to dismiss is *de novo*. *Karas v. Strevell*, 227 Ill. 2d 440, 451 (2008).

Here, the defendants argue that the portion of the franchise fee based on revenues from cable modem services is subject to a finding of both express and conflict preemption. The "ultimate touchstone" of our preemption analysis must be the intent of Congress. *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516, 120 L. Ed. 2d 407, 422, 112 S. Ct. 2608, 2617 (1992). To aid in determining that intent, we examine the legal developments leading to the FCC's 2002 declaratory ruling underlying the defendants' decision to terminate their payment of the disputed fees.

A. *The Development of Section 542(b)*

In 1972, the FCC capped local cable franchise fees due to concerns that:

"many local authorities appear to have extracted high franchise fees more for revenue-raising than for regulatory purposes. Most fees are about five or six percent, but some have been known to run as high as 36 percent. The ultimate effect of any revenue-raising fee is to levy an indirect and regressive tax on cable subscribers." *In re Amendment of Part 74, Subpart K, of the Commission's Rules and Regulations Relative to Community Antenna Television Systems*, Cable Television

Report & Order, 36 F.C.C.2d 143, at ¶¶171, 185 (FCC February 3, 1972) (*Community Antenna Television Systems*).

The FCC set the franchise fee cap at 5% and preempted provisions in franchise agreements imposing higher fees. *Community Antenna Television Systems*, 36 F.C.C.2d 143, at ¶186.

In 1985, Congress codified the FCC's regulatory scheme in Title VI of the earlier Federal Communications Act of 1934. See Communications Act, Pub. L. No. 98-549, 98 Stat. 2779 (October 30, 1984) (effective 60 days after enactment, 98 Stat. 2806). These enactments included a franchise fee cap in section 542(b), providing that:

“For any twelve-month period, the franchise fees paid by a cable operator with respect to any cable system shall not exceed five percent of such cable operator's gross revenues derived in such period from the operation of the cable system.” 47 U.S.C. §542(b) (Supp. 1984).

By codifying the FCC's regulatory scheme, Congress adopted the FCC's underlying purpose and rationale, in the absence of any contrary showing. Thus, the changes expressed congressional concern over the misuse of franchise fees for revenue-raising purposes because excessive fees effectively created a regressive, indirect tax on subscribers. *Community Antenna Television Systems*, 36 F.C.C.2d 143, at ¶¶171, 185.

Congress again amended the Communications Act in 1996, encouraging cable operators to employ technological advances and provide new services. Although Congress did not alter the amount of the franchise fee cap, it added language limiting the collection of the 5% fees to a “cable operator's gross revenues derived *** from the operation of the cable system *to provide cable services*.” (Emphasis added.) Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996). Before the 1996 amendments, the gross revenues from any cable system operation could be used to calculate the franchise fee, capping that fee at 5%. After the amendment, however, the fee could be based on only revenues from cable system operations providing “cable services.” Thus, the 1996 amendment expressed a congressional intent to limit the scope of the revenues that could be used to calculate franchise fees.

After cable modem service became available to provide faster Internet access in 1998, local cable franchising authorities also began imposing the same 5% franchise fees on those revenues. In response, the FCC used its regulatory powers to restrict further the revenues included in calculating the 5% franchise fee ceiling. On March 15, 2002, the FCC interpreted Congress' 1996 amendment to section 542(b) limiting the cable franchise fees to 5% of a "cable operator's gross revenues derived *** from the cable operation of the cable system to provide *cable services*." (Emphasis added.) Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996). In its ruling, the FCC stated that "*cable modem service* as currently provided is an interstate information service, *not a cable service*." (Emphases added.) FCC Ruling, 17 F.C.C.R. at 4819, ¶33. The FCC concluded: "[g]iven that we have found cable modem service to be an information service, *revenue from cable modem service would not be included in the calculation of gross revenues from which the franchise fee ceiling is determined*." (Emphasis added.) FCC Ruling, 17 F.C.C.R. at 4851, ¶105.

The United States Supreme Court upheld that ruling as decisive and entitled to deference in *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967, 999-1000, 162 L. Ed. 2d 820, 849-50, 125 S. Ct. 2688, 2709-10 (2005), but did not independently rule on its meaning. The parties in this case do not dispute the validity of the FCC Ruling and do not rely on *Brand X* in arguing the substantive issues in this appeal. The parties' focus is the FCC's 2002 ruling forming the basis for the defendants' argument that the franchise fee provision in their agreement with the City is preempted by federal law.

B. *Franchise Renewal Agreement Provisions*

In its complaint, the City alleges that the defendants violated section 4.1 of the franchise renewal agreement, entitled "Franchise Fee." That section states:

"[p]ursuant to Section 4-280-170(A) and (B) of the Cable Ordinance, the [franchisee] shall pay to the City a *franchise fee* of five percent (5%) of the annual gross revenues received

by the [franchisee] during the period of its operation under this Agreement.” (Emphasis added.)

This language expressly requires the franchisee to pay a single franchise fee of 5% of its yearly gross revenues. The agreement does not, however, define the key phrase “gross revenues.” Instead, it states that “all terms, phrases, words or their derivations shall be defined as set forth in Section 4-280-030 of the Cable Ordinance” whenever possible, “[u]nless the context clearly indicates that a different meaning is intended.”

In the Chicago Cable Communications Ordinance, section 4-280-030(N) defines “[g]ross revenues” as “revenue derived directly or indirectly from the operation or use of all or part of a cable television system *** including, but not limited to, revenue from *regular subscriber service fees, [and] auxiliary service fees.*” (Emphasis added.) Chicago Municipal Code §4-280-030(N) (2001). “‘Regular subscriber service’ means the distribution to subscribers of signals over the cable television system on all channels *except *** those intended for reception by equipment other than a television broadcast receiver.*” (Emphasis added.) Chicago Municipal Code §4-280-030(T) (2001). Because cable modem service is not intended to be received by a television broadcast receiver, it is not a “regular subscriber service,” and the parties do not argue that it falls within that category. Accordingly, fees from cable modem service are not regular subscriber service revenues included in the franchisee’s annual gross revenues used to calculate its section 4.1 franchise fees.

Section 4-280-030(N)’s definition of “[g]ross revenues,” however, also includes revenue from auxiliary services. Chicago Municipal Code §4-280-030(N) (2001). Section 4-280-030(A) of the Cable Ordinance defines “[a]uxiliary services” as:

“any communications services in addition to ‘regular subscriber services’ including, but not limited to *** data or other electronic transmission services, *** home shopping services, interactive two-way services and *any other service utilizing any facility or equipment of a cable television system operating pursuant to a franchise granted under this chapter.*” (Emphasis added.) Chicago Municipal Code §4-280-030(A) (2001).

Applying this definition, cable modem service revenues would constitute “auxiliary service fees” because cable modem service falls within the Cable Ordinance’s broad classification of an “auxiliary service” as “any other service” using any cable system facilities or equipment. Thus, under the terms of the parties’ agreement and the Cable Ordinance, revenue from cable modem services is included in the annual gross revenues used to calculate the franchise fees due under section 4.1.

Two other Cable Ordinance provisions are also relevant to this dispute. The agreement provides that “[t]he terms and conditions set forth in *** Section 4 are pursuant to the terms and conditions set forth in Sections 4-280-050(C) and 4-280-170 of the Cable Ordinance.” Section 4-280-050(C) discusses the required fees in the franchise approval process and therefore is not relevant to the issues presented in this appeal. Chicago Municipal Code §4-280-050(C) (2001). Section 4-280-170 is relevant, however, because its paragraph A mandates that a franchisee “pay to the city *a franchise fee* of not less than five percent of its annual gross revenues during the period of its operation under the franchise.” (Emphasis added.) Chicago Municipal Code §4-280-170(A) (1993). Thus, both the language of section 4.1 and section 4-280-170(A) of the Cable Ordinance authorizes the imposition of a 5% single franchise fee. Section 4 then specifies the details of that one franchise fee. Notably, the agreement expressly states all terms and conditions in both section 4 and section 4-280-170 are to be understood “as interpreted and applied in accordance with Section 542 of the Communications Act.” Therefore, we next examine section 542 and its interaction with section 4 of the parties’ agreement.

C. The Interplay of Section 4 of the Agreement and Section 542

The language of the section 542 of the Communications Act is at the core of the parties’ arguments. Section 542 states, in relevant part:

“(a) Payment under terms of franchise

Subject to the limitation of subsection (b) of this section, any cable operator may be required under the terms of any franchise to pay *a franchise fee*.

(b) Amount of fees per annum

